# Event summary of Session 3

## Overview of forensic investigations

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## A. Forensic Investigation

### Overall

- Identify:
  - ✓ the relevant frauds
  - ✓ the perpetrator(s)
  - ✓ the time period during which the fraud has occurred
  - ✓ how the fraud was perpetrated and concealed?
  - ✓ how the assets were moved/ converted?
  - ✓ the amount of the losses, which need to be quantified, as a result of the fraud

- Gather evidence that could be presented in the court

- Suggest measures that can prevent similar fraud in the future

### Objective of an Investigation

- Each forensic investigation will have its specific objective:
  - ✓ responding to allegations
  - ✓ report wrongdoings to law enforcement agencies or regulators
  - ✓ criminal or disciplinary actions
  - ✓ recovery of assets
  - ✓ prevention of future incidents

- The following factors will be taken into consideration
  - ✓ regulatory or insurance requirements
  - ✓ cost and timing
  - ✓ disruption to business
  - ✓ publicity, i.e. the image of the concerned organizations

### Responding to Allegations

- Allegations would commonly be sourced from:
  - ✓ Whistleblower's report; whistleblower could either be internal or external parties
  - ✓ Short seller's report; the short seller's allegations may prompt the relevant companies to do investigations to respond the allegations
  - ✓ Internal / external auditors, identifying red flags through performing audit procedures
  - ✓ Regulators

- Consider which allegations are worthy of investigation, regardless of their sources.

### Types of Investigation

- Financial statement fraud
  - ✓ Overstatement of revenues

- ✓ Understatement of liabilities/expenses

- Misappropriation of assets
  - ✓ Misuse of assets
  - ✓ Fraudulent disbursements
  - ✓ Theft of cash, intellectual properties or other assets

- Corruption, taking personal benefits via his or her position
  - ✓ Conflicts of interests, where fraudsters have undisclosed interests
  - ✓ Bribery, where fraudsters offer valuable items to bribe another party, to influence his or her decisions
  - ✓ Kickbacks

- Stakeholders of an Investigation
  - ✓ Shareholders / investors
  - ✓ Board of directors (who have fiduciary duties to promote best interests of the companies) / audit committee / special committee
  - ✓ Senior management
  - ✓ Auditors
  - ✓ Regulators, law enforcement agencies
  - ✓ Insurance companies; they would like to know the investigation results for them to ascertain the reasonableness of the insurance claims.

- Consider the composition of the investigation team
  - ✓ Internal or external team
    - ❖ Independence
    - ❖ Expertise
  - ✓ Members/ skill sets

- Stages of a Forensic Investigation
  - ✓ Responding to allegations via conducting initial assessments
  - ✓ Scoping and planning
  - ✓ Gathering of information
  - ✓ Investigation – analysis of information gathered
  - ✓ Preliminary findings
  - ✓ Interviewing the identified individuals
  - ✓ Additional investigation may be needed after the initial assessment
  - ✓ Reporting

## B. Planning and managing an investigation

- Nature and Purpose of an Investigation Plan

  - ✓ Foundation of an investigation
  - ✓ Checklist that set out the overall direction and structure of an investigation
  - ✓ Maintaining the focus of an investigation, and ensuring the right issues and concerns are being addressed
  - ✓ Setting out the boundaries of an investigation, to focus only on the areas of concern
  - ✓ Sufficiently dynamic and flexible; the plan can be expanded or amended as more information is uncovered during the course of an investigation

- Key Components of an Investigation Plan

  a. Investigation overview, disclosing

     ✓ the allegations or suspected fraud/misconduct being investigated
     ✓ how the information came to the light?
     ✓ known facts/ chronology of the relevant events
     ✓ results of any initial enquiries
     ✓ the reasons of carrying out investigations

  b. Scope and purpose

     ✓ Setting out the boundaries of the investigation and what the investigation is trying to achieve or the rationale of the investigation.

  c. Resources, including people required, information and evidence available, and expert opinion

  d. Timeframe to complete an investigation

  e. A list of affected persons

  f. A list of responsible individuals who will help the investigation

  g. The work and activities to be carried out in order to gather information and evidence on the core issues to be addressed by the investigation.

- Managing an investigation

  Engagement management:
  ✓ Conflict check clearance
  ✓ Client/ engagement acceptance
  ✓ Proposal/ engagement letter
  ✓ Fee Estimates

  File and record-keeping system:
  ✓ Accessibility of information gathered
  ✓ Handling original documents and sensitive information
  ✓ Security and confidentiality of storage
  ✓ Access to data review platform should only be provided to the concerned investigation team

  Communication and reporting protocols with stakeholders:
  ✓ Intervals of updates, which should be agreed beforehand, e.g. verbal vs written, formal vs informal
  ✓ The ways on how to deal with other third parties or media need to be determined in advance
  ✓ Considering who will have the access, and use the deliverables and reports
  ✓ Legal privilege:

Proper procedures should be put in place to maintain privilege on the relevant correspondences/ documentations; for example, the forensic investigations may be led by legal counsels to ensure that the relevant documentations are protected from disclosing from disclosing to third parties.

Legal privilege is unlikely available in a situation where a forensic accountant will serve as a testifying or consulting expert in court.

- Phased approach to investigation help ensure

  - ✓ effective time and cost management
  - ✓ each phase acting as a checkpoint, allowing the investigation team to revisit the work plan, and to decide whether to expand or limit subsequent phase(s) or entire investigation scope
  - ✓ a faster response to issues identified
  - ✓ Common phases:
    - ❖ Identification
    - ❖ Preservation and data collection
    - ❖ Review and examination
    - ❖ Reporting

## C. Types of evidence, evidence integrity and chain of custody

**Type of evidence**

Example: A procurement officer has introduced a new tenderer to his employer, in which he is an interested party, but he did not disclose this relationship to his boss. This officer is able to influence his boss's decision to purchase from the tenderer at an inflated price.

- Direct evidence (e.g. representations provided by the officer during the interview), i.e. what a person actually said or did.
- Documentary (e.g. statutory filing showing that the officer is in fact a director of the tenderer), and circumstantial evidence (e.g. a price comparison table prepared by the investigation team, showing that cheaper options are available from other tenderers), from which facts may be inferred
- Hearsay (e.g. interviews with the officer's colleagues who indicated that the new tenderer has no proven track record), i.e. what a witness said about what another person had seen or done
- Expert evidence from someone who is deemed to possess expertise in or experience of the relevant subject area

**Common information sources: internal records**

- Accounting information, including audited accounts, management accounts, trial balances, bank statements, tax returns, valuation reports.
- Policies and procedures (to check against the existing practices, and to identify possible gaps for frauds)
- Legal and statutory records (providing factual information to the investigators), including contracts and agreements, title deeds, statutory filings, etc.

- Electronic records, including emails, computers, servers, mobile phones and external storage devices.

**Common Information Sources: External Records**

- The underlying purposes are to check the consistency between internal and external records, and to identify any undisclosed relationship.
- Examples include company, legal and land searches, regulatory filings, annual reports, etc.

**Evidence Integrity and Chain of Custody**

- In order to preserve evidence integrity and maintain chain of custody:
  - ✓ Document the collection process
  - ✓ Where possible, obtain original documents and records, or medium (e.g. the hard disk)
  - ✓ Plan before collection, particularly for electronic data - such as to consider software and hardware involved, the structure of the network, the applicable security and IT policies and procedures.
  - ✓ Timing of collection is also critical, particularly for electronic data – they are more easily manipulated and destroyed then hardcopy data
  - ✓ Store the collected evidence in safe and secure environment
  - ✓ Organize in a logical manner, for example, by transactions; issues to be investigated; or custodians
  - ✓ Maintain a database or log to record all documents obtained
  - ✓ Work with copied documents and preserve original

## D. Preparation for investigative interview

Interviews are important sources to obtain information, as investigators are able to have direct interactions with the targets. Considerations include:

- Identifying the possible interviewees
- Planning the interview schedule, in particular, avoiding delays between interviews to minimize the opportunity for collusion among the targets, picking a location where interviewees feel comfortable
- Arranging the interview, with factors being considered include how to contact the interviewees (e.g. through the HR department), the mode of interviews (e.g. face to face, video, telephone), the corresponding locations, confidentiality, legal privilege, who should be present in an interview (there should be at least one more investigation team member who will take notes to support the main investigator), interpreter, etc.?
- Preparing for the interview, e.g. setting objectives (this should be taken care of as sometime you can only get hold of one chance to interview a target), familiarizing yourself with the details of the case
- Prepare a list of essential issues / questions to be covered
- Consider what evidence/documents should be shown to the interviewee and arrange them
- Anticipate potential difficulties that may arise and how to deal with them
- Starting the interview with easy questions
- Consider how the interview will be recorded (e.g. interview notes, electronic recording) and make the necessary arrangements
- Types of questions for different situations (e.g. open-ended; closed; follow-up questions)

- Performing evaluation after the interview: Assess the value of the information provided and how that information can be used in or affects the investigation; assess whether documents that you were not aware of would aid your investigation and, what steps you would need to take to obtain them; and whether or not additional interviews are required.

## E. Tools available to assist in an investigation

- Legal searches available under the government, e.g. land registry, company registry, and other bodies like under the HKEX, the HKMA, the SFC, the Insurance Authority
- Internet (e.g. search engines), data service provider, social media bearing in mind the information on hand is the most updated version
- Electronic data discovery, process of identifying, extracting, collecting, processing and storing electronic data in a form which the investigator can easily use and navigate. Functionalities of computer forensic analysis software.
- Data analysis (e.g. link analysis, social network analysis), transforming large volume of raw data into formats that can be analysed through a process of inspecting, cleansing, transforming, and modelling data
- Timeline - Chronological analysis of sequence of events. Can be used to show e.g. the significant events where information is inconsistent or where accounts diverge
- Relationship mapping, visual presentation of relationship show the subject of the investigation and its associations and connections with other individuals and/or entities; actions such as transactions and fund flows between these parties

## F. Investigation report

- Factors to consider before drafting the report include format, purpose (e.g. for internal use or to address the enquiries from regulatory authorities)

- As different versions of draft investigation reports may be made discoverable by the opposing litigant, you should try to minimize the number of these reports or otherwise you may be asked in court why there are multiple versions.

- Use clear and simple language; be impartial and objective; substantiate observations and findings.

## G. Further work beyond the investigation

- Recovery of assets, remediation and improvement to internal control and procedures; if misconduct allegations against an employee have been found valid, the employer should consider disciplinary actions against the employee.